No. 83-85

In The

Supreme Court of the United States

October Term, 1983

EASTERN FOODS, INCORPORATED,
Petitioner,

vs.

R. C. McENTIRE,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE FOURTH CIRCUIT COURT OF APPEALS

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The Respondent conceives that the four questions set out in the Petition for a Writ of Certiorari comprise essentially two questions as follows:

QUESTIONS PRESENTED

(Petitioner's Questions Presented 1 and 2)

I. Should This Court Review a Decision of the Fourth Circuit Court of Appeals Which Affirmed the Finding That McEntire Pled and Proved Eastern Foods Either Contractually Obligated Itself on an Account Payable to R. C. McEntire or Took Over the Contractual Obligation of B & B Produce Processors Which It Merged Into Its Operations?

(Petitioner's Questions Presented 3 and 4)

II. Should This Court Review a Decision of the Fourth Circuit Court of Appeals Affirming the District Court's Charge to the Jury Concerning the Appropriate Measure of Damages in a Case of Corporate Successor Liability?

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INTRODUCTION TO ARGUMENT

This action arises out of a business contract originally made between McEntire and B & B Produce Processors under which McEntire sold produce to B & B. Eastern took over B & B and, McEntire asserted, thereby became obligated on the contract. McEntire also asserted that

Eastern had made fraudulent misrepresentations but the jury did not award any punitive damages for fraud. Eastern contends that it did not know McEntire was claiming liability by virtue of the takeover of or merger with the B & B operation. Eastern also contends that the charge to the jury of the law of damages was in error.

Eastern urges upon the Court that McEntire did not plead facts which gave notice of the merger issue; that if notice of merger is not discernable from the Complaint then it can only come through an amending of the Complaint to conform to the evidence as permitted under Rule 15(b) of the Federal Rules of Civil Procedure; and, that the District Court's permitting the verdict to stand constitutes a violation of Rule 15(b) so extreme that it becomes a violation of due process.

In response, McEntire believes it is not even necessary to reach the Rule 15(b) issue of amending the pleadings. The original Complaint alleged in Paragraph 8 of the First Cause of Action:

> That the Defendant, Eastern Foods, took all of the assets of B & B Produce Processors, Inc., and hired the services of Dick Bowers and other B & B employees to work for it, and thereafter, after all benefits of the buy-out of B & B had gone to Eastern Foods, the Defendant stopped making all payments to the Plaintiff, the last payment being made at the end of November, 1978.

Under Rule 8 of the Federal Rules of Civil Procedure, sufficient notice has been given in concise manner that McEntire alleged Eastern Foods had taken over or merged B & B into Eastern Foods. Even if it is accepted for purpose of argument that it was necessary to look to Rule 15(b) and amplify the Complaint to conform to the proof, the result reached below is proper because East-

ern Foods recognized and vigorously litigated the merger issue. There is no decision below involving Rule 15(b) that rises to the level of a violation of the Fifth Amendment or Fourteenth Amendment of the United States Constitution.

Eastern also urges upon the Court that the proper measure of damages is limited to those recoverable under the trust fund theory where assets are followed into the hands of a company who obtains an asset for no consideration; that the District Court should not have charged that a successor corporation can be fully liable for the debt; and, that to so charge the jury constitutes a violation of Rule 51 of the Federal Rules of Civil Procedure so extreme that it becomes a violation of due process.

In response, McEntire believes that the correct measure of damages was charged to the jury. The takeover or mergering of one corporation by another gives rise to full liability for the contract obligations of the corporation taken over without limiting recovery to the value of the assets of the corporation which was taken over. For the District Court to charge elements of damages consistent with such a principle does not suggest a violation of Rule 51 at all. It is simply a correct proposition of state substantive law. It does not remotely involve the Fifth Amendment or Fourteenth Amendment of the United States Constitution.

STATEMENT OF FACTS

In this Petition for Writ of Certiorari, Eastern Foods, Inc., challenges a judgment entered in favor of R. C. McEntire & Company for the remaining balance of an open account owed McEntire by B & B Produce Processors, Inc. Eastern's principal contention is that the District Court as well as the Fourth Circuit Court of Appeals erred in permitting McEntire to recover on a theory of *de facto* merger, or transferee liability for the breach of contract. Also, Eastern contends that the District Court and the Fourth Circuit Court of Appeals erred by charging an inappropriate measure of damages.

The Plaintiff, R. C. McEntire & Company, is in the wholesale produce business and sells products such as tomatoes and lettuce. In February, 1978, a course of dealing began between McEntire and B & B Produce Processors. B & B processed produce for fast food restaurants. Its major account was Hardee's. B & B was operated by Dick Bowers and Ralph Davis, who were both former officers of Hardee's. The Hardee's account represented approximately ninety (90%) percent of the B & B business and was a very large account for this type of business.

B & B had contracted with Hardee's to sell lettuce and tomatoes at a fixed rate for a period of time. The price of these products began to increase dramatically on the wholesale market, and B & B started to experience cash flow problems as a result.

The purchase and sale of produce is done by verbal agreements in the normal custom and usage of the trade. McEntire and B & B experienced no serious difficulty operating on an open account from February, 1978, until approximately the first of August, 1978. In mid-

July, 1978, Mr. McEntire went on a two-week vacation, expecting some substantial payments from B & B. Instead, when he returned around the first of August, 1978, he found the account had increased and was due in the amount of One Hundred Fifteen Thousand Eight Hundred Ninety-Six and 50/100 ($115,896.50) Dollars. McEntire immediately put B & B on a COD basis and tried to establish a system of payments, but it was unsuccessful.

On August 30, 1978, McEntire lodged an informal Complaint against Bowers and B & B with the United States Department of Agriculture. In response to such a Complaint, the Department has the power to suspend the right of a buyer to do business in the perishable commodities market unless he satisfies his debts.

In response to this Complaint, which had the potential to deprive Bowers and B & B of the right to handle the Hardee's account, a series of events took place. The Defendant, Eastern Foods, Inc., began a number of acts leading to the takeover of B & B. Both Eastern and B & B began negotiations with McEntire designed to abate any efforts by McEntire to go forward with the complaint procedures at the U. S. Department of Agriculture which could have assured McEntire of payment and risked the loss of the eligibility of Bowers and B & B to have the Hardee's account. Eastern Foods needed Bowers and B & B because they had the necessary contacts with Hardee's to get the Hardee's account.

On September 12, 1978, The U.S.D.A. acknowledged McEntire's informal Complaint. On September 13, 1978, Bowers and B & B got Fifty Thousand and No/100 ($50,000.00) Dollars from Eastern Foods and signed a Note. On September 22, 1978, the U.S.D.A. wrote McEntire and explained the procedures for filing a formal

Complaint. During the period from mid-September, 1978, until mid-October, 1978, the party with whom McEntire was dealing shifted over from B & B to Eastern Foods.

Also during this time, Eastern Foods created a set of documents which on their face purported to be an Agreement to manage B & B, coupled with an option to buy B & B. The activities engaged in by Eastern Foods, as well as the information and communications it gave out, show clearly that what Eastern Foods was doing, in fact, was merging the B & B entity into Eastern Foods.

In early September, 1978, Bowers agreed to pay off the account balance at the rate of Two Thousand and No/100 ($2,000.00) Dollars per week, and these payments were begun. This was about the same time that Eastern Foods had begun to pump money into B & B.

McEntire had several telephone conversations with Mr. Bellamy, Vice-President of Eastern Foods. These conversations dealt with the agreement of Eastern Foods to undertake the continuing payment of the unpaid balance at the rate of Two Thousand and No/100 ($2,000.00) Dollars per week and McEntire's continuing to forebear on his right to pursue a Complaint with the U.S.D.A.

McEntire even made a trip to Atlanta to meet with Mr. Bellamy of Eastern Foods and inspect their facilities in order for Mr. McEntire to be satisfied of Eastern Food's ability to comply with such an agreement. Mr. McEntire was persuaded and agreed.

On September 29, 1978, a Management Agreement was signed giving Eastern Foods control over B & B and an option was signed that same date giving Eastern Foods the right to buy B & B. On October 1, 1978, a Restated Management Agreement was signed giving Eastern Foods virtually total control over B & B.

On October 13, 1978, McEntire wrote the U.S.D.A. and asked it to hold the Complaint in abeyance. On October 18, 1978, Dick Bowers wrote the U.S.D.A. and advised that B & B Produce and Eastern Foods were merging and that, further, Eastern Foods had met with McEntire and made satisfactory financial arrangements.

At approximately this time, Eastern Foods, in addition to agreeing to pay off the balance at the rate of Two Thousand and No/100 ($2,000.00) Dollars per week, also persuaded McEntire to sign a document called an "Irrevocable Offer", which would give Eastern Foods the option to liquidate the balance at a fifty (50%) percent discount by paying twenty-five (25%) percent of the balance in cash and the remainder in twelve (12) payments. The document purports to run from McEntire to B & B. It was prepared by Eastern Foods and presented to McEntire by Eastern Foods. It bears no date. It was never accepted and acted upon by Eastern Foods or B & B.

On October 24, 1978, the U.S.D.A. wrote McEntire, advising that it would set aside its file until November 5, 1978, in response to McEntire's request. Further discussions went on between McEntire and Eastern Foods. The agreement to pay Two Thousand and No/100 ($2,000.00) Dollars per week was being honored during this time by Eastern. On November 17, 1978, McEntire was persuaded to extend the "Irrevocable Offer" which had expired on November 15, 1978.

During this period of dealing with McEntire, Eastern Foods had been rapidly absorbing B & B into Eastern Foods. Mr. Bowers and Mr. Davis were introducing personnel of Eastern Foods to the Hardee's contacts and explaining that B & B was merging with Eastern Foods. B & B employees went on the Eastern Foods' payroll. Warehouse operations of the two entities were consoli-

dated as one operation. Vehicles of B & B were used by Eastern Foods. The Hardee's account was taken over by Eastern Foods.

While these actions were being taken, Eastern Foods continued to send checks to McEntire from Atlanta in the amount of Two Thousand and No/100 ($2,000.00) Dollars per week. The checks were sent from Eastern Foods in Atlanta and written against a bank account of Eastern Foods in Charlotte set up in the name of "Bell and Brooks". Bellamy, Vice-President, and Brooks, President, were the two principals at Eastern Foods who dealt with McEntire.

While Eastern Foods was completing the merger of the B & B operation into its own and securing the Hardee's account, it paid the outstanding balance which was originally One Hundred Fifteen Thousand Eight Hundred Ninety-Six and 50/100 ($115,896.50) Dollars down to a balance of Eighty-Eight Thousand Seven Hundred Seventy-One and 50/100 ($88,771.50) Dollars. Once the merging of B & B into Eastern Foods was complete and the Hardee's account secure, Eastern Foods breached its promise to pay the balance off at the rate of Two Thousand and No/100 ($2,000.00) Dollars per week. The last payment was made for the week ending November 30, 1978.

The case was tried before the United States District Court Judge Robert F. Chapman during April 8-10, 1981. The jury returned a verdict in the amount of Eighty-Eight Thousand Seven Hundred Seventy-One and 50/100 ($88,771.50) Dollars, together with interest from November 30, 1978, which was the date of the last Two Thousand ($2,000.00) Dollars payment from Eastern Foods to McEntire. On appeal, the judgment of the District Court was affirmed.

REASONS FOR DENYING WRIT

I. Should This Court Review a Decision of the Fourth Circuit Court of Appeals Which Affirmed the Finding That McEntire Pled and Proved Eastern Foods Either Contractually Obligated Itself on an Account Payable to R. C. McEntire or Took Over the Contractual Obligation of B & B Produce Processors Which It Merged Into Its Operations?

(Eastern's Questions 1 and 2)

Eastern Foods, Inc., contends that the takeover or merger was not pled. Eastern further asserts that it was surprised by the merger issue at trial. Finally, Eastern contends there was insufficient evidence to support a verdict that Eastern Foods had become obligated on the B & B contract. Both the District Court and the Fourth Circuit Court of Appeals have pointed out that Paragraphs 5 and 8 of the Plaintiff's Complaint set forth facts sufficient to put the Defendant on notice of the Plaintiff's theory of *de facto* merger. The Complaint alleged in part:

> "That the Defendant, Eastern Foods, took all of the assets of B & B Produce Processors, Inc., and hired the services of Dick Bowers and other B & B employees to work for it, and thereafter, after all benefits of the buy-out of B & B had gone to Eastern Foods, the Defendant stopped making all payments to the Plaintiff, the last payment being made at the end of November, 1978."

Both the District Court and the Fourth Circuit Court of Appeals also pointed out that Eastern Foods had actual notice of the *de facto* merger theory because they

secured the services of a law school professor for the purpose of acting as an expert witness on the merger issue. In addition, the Fourth Circuit opinion reveals that Eastern Foods deposed McEntire's witness on the merger issue and McEntire's trial counsel mentioned merger in his opening statement to the jury. The opinion of the Fourth Circuit Court of Appeals states:

> "It is clear from the facts recited that Eastern Foods had notice of the merger issue, was not surprised by it, and, indeed, even prepared for it."

Also, aside from any contractual obligation resulting from merger, the decision of the Fourth Circuit of Appeals points out that there is sufficient evidence that Eastern independently obligated itself in a contract with McEntire:

> "In addition, McEntire's agreement to forego prosecution of it's Complaint before the U.S.D.A. in exchange for Eastern's weekly payment is sufficient consideration to support McEntire's breach of contract claim."

The specific reference in the opinion of the Fourth Circuit is to a letter written on October 18, 1978, and sent to the Complaint Section of Regulatory Branch of the Fruit and Vegetable Division of the U.S.D.A. and reads as follows:

> "This letter is in regards to the informal Complaint from R. C. McEntire to the P.A.C.A. The following arrangements have been agreed upon by R. C. McEntire, Eastern Foods and B & B Produce. B & B Produce and Eastern Foods are venturing into a merger of our companies. Eastern Foods met with Buddy McEntire and made financial arrangements

satisfactory to R. C. McEntire. You should receive your letter from R. C. McEntire explaining the terms within two or three days."

There was no surprise to Eastern that McEntire asserted Eastern was obligated on the B & B account because of having taken over the entire business of B & B. There was sufficient evidence to support a jury factual finding. The affirming of the result by the Court of Appeals does not raise a due process issue.

II. Should The Court Review A Decision Of The Fourth Circuit Court Of Appeals Affirming The District Court's Charge To The Jury Concerning The Appropriate Measure Of Damages In A Case Of Corporate Successor Liability?

(Eastern's Questions 3 and 4)

Next, Eastern Foods contends that an inappropriate measure of damages was used. Eastern argued that McEntire's recovery was limited to the value of the property Eastern Foods received in the take-over of B & B. Eastern Foods cites the South Carolina case of *Beckroge v. South Carolina Power Company*, 197 S. C. 184, 15 S. E. 2d 124 (1941). In *Beckroge* it was held that where a power company received assets from a gas company for no consideration, the gas company's creditors could follow those assets into the hands of the purchasing corporation to the extent of their value. This theory of damages, the so-called trust fund theory of damages, is a correct principle of law; however, it has no application in the present case. Upon the consolidation or merger of two corporations, the transferee or successor corporation remains fully liable for the liabilities of the transferor corporation. The distinction between

the trust fund theory of damages and the merger theory of damages is that in the former there is a purchase or acquisition of another company's property where, in the latter, there is a consolidation or merger of the two companies.

It has long been a principle of law that upon a consolidation or merger of two corporations, the transferee or successor corporation remains fully liable for the liabilities and debts of the transferor corporation. In Section 7119 of Fletcher, *Encyclopedia Private Corporations*, the correct rule is stated as follows:

> A consolidated company is liable on the claims against the constituent companies without regard to the amount of assets received from them. This is undoubtedly the true rule, although language used in some of the decisions might be construed to indicate a limitation of liability to the property received.

In Section 7122 of the same work, the distinction is made between a mere purchase or acquisition of another company's property and a situation in which there is a consolidation or merger or some other undertaking. In Section 7122, it is pointed out that:

> The purchasing or transferee company, that is to say, is not liable on the other company's obligations merely by reason of its succession to such company's property. An express agreement, or one that can be implied, to assume the other company's debts and obligations, is necessary; or the circumstances must warrant a finding that there was a consolidation or merger of the corporations, or that the transaction was fraudulent in fact, or that the purchasing company was a mere continuation of

the selling company; the foregoing constitute the so-called exceptions to the general rule.

This rule as set out by Fletcher above has been followed by a multitude of cases which are cited in that work in support of the rule and is virtually identical to the language found in 19 Am. Jur. 2d, *Corporations*, §1546, which provides:

> There are certain instances, however, in which the purchaser or transferee may become liable for the obligations of the transferor corporation: (1) where there is an express or implied assumption of liability; (2) where the transaction amounts to a consolidation or merger; (3) where the transaction was fraudulent; (4) where some of the elements of a purchase in good faith were lacking, as where the transfer was without consideration and the creditors of the transferor were not provided for; or (5) where the transferee corporation was a mere continuation or reincarnation of the old corporation.

Judge Chapman's charge on the rights of creditors against transferee or successor corporations was a sound statement of the law in that regard.

With repect to damages, Judge Chapman charged the following:

> Normally, the damages recoverable from breach of contract are those which follow as a natural consequence supposed to have been within the contemplation of the parties at the time the contract was entered into.
>
> One who breaches a contract to pay money is normally liable for the amount of money specified in the contract itself.

This is the classic definition of damages for breach of contract, and it would be both the measure of damages with respect to any independent agreement between Eastern Foods and McEntire, as well as any contract obligation which Eastern Foods is obligated under as a result of a *de facto* merger of B & B.

Eastern Foods would have the Court limit damages to the value of the assets received. There is no basis in law for the application of the trust fund theory in this case. The jury may well have found that Eastern Foods independently obligated itself under the contract, and Judge Chapman's statement of the measure of damages in a breach of contract action is appropriate. On the other hand, the jury may have concluded that Eastern Foods was obligated under the contract of B & B as the result of a merger in fact, and in that instance, Judge Chapman's charge is again the correct measure of damages. 19 Am. Jur. 2d, *Corporations*, §1554, provides, in part:

> Generally speaking, where a corporation succeeds to the assets of another corporation by virtue of a consolidation or merger and not by way of purchase, the new or resulting corporation is liable for the debts and contracts of the other corporation, although there is no statute imposing any liability and no agreement assuming it. Corporations cannot, by consolidation, escape the obligation to pay debts incurred before the consolidation or defeat the right of their creditors to subject their property to the satisfaction of such debt.

The correct measure for damages for breach of the contract obligations of Eastern Foods to McEntire are those which followed as a natural consequence of the breach or which may reasonably be supposed to have been within the contemplation of the parties at the time the agreements were entered into. That amount was the

balance due on the account and was obviously within the contemplation of McEntire, Eastern Foods and B & B. The District Court's charge to the jury of the measure of damages was not only correct but it in no way raises an issue of due process which requires further review.

CONCLUSION

A decision by the Fourth Circuit Court of Appeals: (1) that there is sufficient evidence to support a finding of liability for the balance due on the account by the successor corporation; and that there was no surprise in this issue being in the trial; and (2) that damages were properly charged, constitute not only a correct resolution of the case, but do not suggest sufficient reason for this Court to exercise its discretion under Rule 17 to review the opinion below. There is no conflict between Federal Courts of Appeals. There is no Federal question which is conflicting with a State Court of last resort. There is no departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. No State Court decision of a Federal question is in conflict with the decision of another State or Federal Court and no Court has decided an important question of Federal Law which needs to be settled.

Respectfully submitted,

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